

GTE further argues that a new network cannot become an effective competitor until it achieves virtually ubiquitous geographic coverage. Also, GTE argues, it must acquire its own POPs in all or virtually all LATAs, or face the competitive disadvantage of incurring additional transport charges which will make its rates uncompetitive. *GTE Comments* at 23-26. However, as WorldCom's own experience demonstrates, a competitive network can impose competitive discipline nationwide simply by being competitive in significant metropolitan areas. That is because there is significant facilities-based competition nationwide. GTE and other IXC's are buying capacity at cost-based rates to go where their networks do not go. Further, the nationwide geographic averaging requirement of section 254(g) precludes interexchange carriers from selectively lowering their rates only in those areas where they encounter significant competition. Indeed, GTE concedes that WorldCom itself does not have POPs in some 90 of the nearly 200 LATAs, and yet is a significant competitor. *GTE Comments* at 24. It is simply not the case that ubiquitous geographical and POPs coverage is necessary before a carrier becomes a significant competitor.

Moreover, as pointed out by Drs. Carlton and Sider, the Qwest network will have POPs covering 78% of the nation's population, while the Williams and IXC networks will have POP coverage of 72% and 61% of the population respectively. Second Carlton/Sider Decl. ¶¶ 21. There is no principle of economics or common sense to support GTE's argument that WorldCom's 82% population coverage is "significant" and qualifies it for membership in the so-called "Big Four," while competing networks with coverage ranging from 61% to 78% are competitively insignificant. As Drs. Carlton and Sider point out, the new networks "will soon have a presence at least as

significant as WorldCom's as recently as two years ago." Second Carlton/Sider Decl. ¶ 34.<sup>55</sup>

GTE argues that for "several years," new entrants will be unable to achieve economies of scale that apply to the "Big Four." *GTE Comments* at 26. But the Qwest network is already in operation. And GTE itself, in its May, 1997 announcement of its purchase of a portion of that network, stated that the network would be "fully operational next year" and will enable GTE "to reach virtually the entire U.S. population." GTE's operational personnel apparently do not have the apprehensions that its lawyers describe.<sup>56</sup>

Finally, GTE argues that there is a shortage of qualified network engineers and telecommunications software developers, and that new entrants will face high and increasing labor costs. *GTE Comments* at 30. The argument makes no sense. To the extent that new entrants bid up the compensation of new technical employees (and attract employees from the incumbents in the process), that raises the cost of technical help for all market participants, including the incumbents. When all participants face the same labor market there is no competitive advantage or disadvantage stemming this factor.

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<sup>55</sup> "WorldCom had only about 110 POPs as recently as 1996. In contrast, by next year, IXC is expected to have deployed 106 POPs, and Qwest is expected to have deployed 125." Second Carlton/Sider Decl. ¶ 34.

<sup>56</sup> On May 6, 1997, GTE announced a series of transactions to "position GTE to have the fastest, most reliable and most secure national network available, enabling end-to-end managed network solutions that we believe will be unmatched in the industry." GTE explained that this network, which it is purchasing from Qwest Communications, would be "fully operational next year" and that "[a]t that point, we will be in a position to reach virtually the entire U.S. population." "GTE Announces Initiatives to Become a Leading National Provider of Telecommunications Services -- Will Acquire BBN in Transaction Valued at \$616 Million -- Purchases Fiber-Optic Network From Qwest -- Creates a New National Sales Service and Marketing Company" available at <<http://www.gte.com/g/news/050697.html>> (visited March 19, 1998).

**D. Potential competitive effects and efficiencies**

**1. The efficiencies resulting from the merger will be significant.**

The Joint Reply discusses why the merger offers significant efficiencies in the interexchange market. Joint Reply at 26-27.<sup>57</sup> This showing is buttressed in the attached Affidavit of Sunit Patel, WorldCom's Treasurer, which describes certain of these efficiencies and cost savings in greater detail.

**2. There is no basis for the argument that the merged company will stop offering significant wholesale discounts.**

GTE's principal argument, echoed by Bell Atlantic, is that, after the merger, WorldCom will withdraw from the wholesale market, or stop offering attractive wholesale prices, in order to prevent resellers from undercutting retail sales to MCI's customer base.

The argument fails as a matter of common business sense. After the merger MCI WorldCom will have only 18% of presubscribed lines, most of which (15%) will come from MCI. Reduced to its basics, GTE is asserting that MCI WorldCom would be willing to stop competing seriously for the wholesale provision of service to over 80% of U.S. customers, an arena in which it has achieved enormous growth in the past, simply to protect a retail customer base of 18%. It is difficult to conceive of a rational businessperson making such a decision.

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<sup>57</sup> The Harris Long Distance Affidavit (at ¶ 71) cites Prof. Hall's statement that there is "an absence of increasing returns in the long-distance market" as being in conflict with MCI WorldCom's estimates of cost advantages resulting from the merger. But Prof. Hall's discussion is in terms of whether "technology has important returns to scale [which would allow] one firm [to] dominate." Hall Decl. ¶ 73. Prof. Hall's point is only that returns to scale are not large enough to lead to a natural monopoly. Prof. Hall's discussion does not mean that some economies or efficiencies would not be realized by two firms, particularly where the two firms are somewhat specialized or differentiate in their service mix and facilities.

achieved enormous growth in the past, simply to protect a retail customer base of 18%. It is difficult to conceive of a rational businessperson making such a decision.

Moreover, MCI WorldCom cannot discriminate against a reseller depending on who the reseller's customers may be.<sup>58</sup> Given AT&T's still-dominant share of retail sales post-merger, it is much more likely that a reseller's customers will be taken from AT&T or some other competitor than from MCI WorldCom. Indeed, as Drs. Carlton and Sider point out, the historical data suggests that "resellers' gains have disproportionately come at the expense of AT&T," thus indicating "that the probability that a reseller wins a customer from MCI is likely to be well below the 15 percent level implied by MCI's share of presubscribed lines." Second Carlton/Sider Decl. ¶ 58. GTE is arguing that MCI WorldCom would deliberately forego otherwise profitable wholesale opportunities, knowing that at most only a small percentage of its wholesale sales might result in loss of a retail customer -- a customer that might be lost anyway to a reseller who obtains capacity from a competitor if MCI WorldCom will not provide it. GTE's argument is simply not plausible.

GTE's argument ignores the history of the long-distance market in another respect. In fact, AT&T (as well as MCI) has a history of substantial participation in the wholesale market.<sup>59</sup> If GTE were right, LDDS would not have bought WilTel, and Qwest would not be buying LCI. In fact,

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<sup>58</sup> The Commission has a long-standing prohibition against unreasonable restrictions on resale of interexchange services. See *In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Domestic Public Switched Network Services*, 83 F.C.C.2d 167 (1980), *aff'd sub nom.*, *National Association of Regulatory Utility Commissioners v. FCC*, 746 F.2d 1492 (D.C. Cir. 1984); see also *In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities*, 60 F.C.C.2d 261 (1976), *motion for reconsideration granted in part and denied in part*, 62 F.C.C.2d 588 (1977), *aff'd*, *AT&T v. FCC*, 572 F.2d 17 (2d Cir. 1978).

<sup>59</sup> Second Carlton/Sider Decl. ¶¶ 66-68.

retail and wholesale operations do coexist in several telecommunications carriers. It is only GTE's warped bias that says they cannot.

If interexchange carriers with retail customers were to refuse to sell to resellers (assuming they could do so legally), the resellers could follow the familiar path of constructing their own facilities, or they can obtain capacity on favorable terms from wholesale-oriented competitors like Qwest, Williams, Level 3 and IXC. GTE itself is a good example of an interexchange carrier that began by reselling intercity services and is now rapidly becoming a substantial facilities-based provider. Facilities-based interexchange carriers face a simple choice: (1) get no revenue from a competitor because the competitor obtains capacity from other facilities-based interexchange carriers or constructs its own; or (2) get some revenue by selling available capacity to the competitor on nondiscriminatory terms. It is not surprising that many facilities-based interexchange carriers, including MCI and AT&T as well as WorldCom, choose the second option -- which incidentally also complies with their FCC-mandated resale obligations. Significantly, GTE cannot point to any evidence that MCI or WorldCom have decreased their involvement in the wholesale market. And of course, if MCI and WorldCom each individually has an incentive to compete for wholesale as well as retail customers, so too will the merged company.

**3. The long-distance market is currently competitive and will remain so after the merger.**

**a. Residential and small business market.**

GTE proclaims that "the retail mass market is not effectively competitive." *GTE Comments* at 38. GTE concedes that WorldCom does not have an established brand name and does not presently participate in the "retail mass market." WorldCom's lack of brand recognition in the mass

market led to the Commission's finding in *Bell Atlantic-NYNEX* that WorldCom was not among the most significant potential entrants to provide local service in New York City.<sup>60</sup>

The facts show that the residential market is fiercely competitive. As previously noted, pricing in this sector is governed by competitive pressures, with prices falling further and faster than access charge reductions.<sup>61</sup> This segment of the market is also subject to pervasive over-the-air and print advertising as well as a massive marketing effort by industry participants. In the AT&T Non-Dominance Proceeding, the Commission found that "residential customers are highly demand-elastic and will switch to or from AT&T in order to obtain price reductions and desired features."<sup>62</sup> The Commission noted the "high churn rate among residential consumers - approximately 30 million changes are expected in 1995."<sup>63</sup> That high "churn rate" has persisted.<sup>64</sup> As Dr. Marius Schwartz, Professor of Economics at Georgetown University and the Department of Justice's expert in the BellSouth South Carolina Section 271 case, observed in discussing the interexchange retail market, "If there is no competition, why do so many customers switch back and forth between carriers each

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<sup>60</sup> *Bell Atlantic/NYNEX*, at ¶ 84.

<sup>61</sup> The Harris Long Distance Affidavit claims that long-distance revenues per minute have been declining because of a decrease in HHI. Harris Long Distance Aff. ¶ 100. However, Harris's chart purporting to prove this proposition (Harris Long Distance Aff. Exh. 27) could just as easily be interpreted to show that revenues per minute have declined as technology has driven costs down. Indeed, Harris admits that "[s]upply costs have tended to decrease, primarily through improvements in technology (reducing switching and transmission costs) and through mandated reductions in access charges." Harris Long Distance Aff. ¶ 100.

<sup>62</sup> Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order FCC 95-427, 11 FCC Rcd 3271 (rel. Oct. 23, 1995) at ¶ 63.

<sup>63</sup> *Id.*

<sup>64</sup> MCI estimates that in 1996, customers changed carriers 50 million times.

#### **IV. MERGER WILL HAVE PROCOMPETITIVE EFFECTS AND WILL NOT REDUCE COMPETITION IN ANY INTERNATIONAL END USER OR INPUT MARKET.**

In the Joint Reply, the Applicants demonstrated that the merger would have procompetitive benefits and would not reduce competition in the relevant U.S. international markets. GTE was the only party in the initial round of comments, filed January 5, 1998, to assert that the merger would have anticompetitive effects in any international telecommunications product market. In its further comments, GTE again was the only party to question MCI/WorldCom's showing with regard to international product markets.

Rather than responding to the Applicants' evidence, however, GTE simply regurgitates its calculation of HHI indices. This simplistic reliance on HHI indices to attack the proposed merger underscores the weakness of GTE's position. Even GTE concedes that HHI indices are merely guidelines. Further, these indices have never been used by the Commission to form the basis for its competitive analysis of telecommunications mergers. GTE cannot point to any evidence that the merger would have an adverse impact on the competitive provision of international services. GTE refuses to recognize that the provision of such services, which is already highly competitive, will become only more competitive as significant existing and new entrants -- including foreign carriers benefiting from the Commission's new rules implementing the WTO Agreement -- accelerate their efforts in this dynamic and growing market.

##### **A. The Merger Will Have Significant Procompetitive Effects**

As the Applicants demonstrated in the Joint Reply, the merger will have significant procompetitive benefits. Through the merger, MCI and WorldCom will combine facilities to create end-to-end global networks. With the entry into force of the WTO Agreement in February 1998,

carriers worldwide now will seek to satisfy their customers' requirements and reduce their costs by providing end-to-end services. A number of foreign carriers already are authorized to provide global facilities-based services from the United States, and more are expected. In order to compete effectively in this global market, which includes traffic originating overseas as well as in the United States, MCI and WorldCom must optimize the use of their network facilities.

Combining the assets and expertise of the two companies will produce significant cost saving synergies that ultimately will reduce the international rates that U.S. consumers pay, a primary goal of the Commission's *Benchmarks Order*.<sup>65</sup> For example, WorldCom has constructed significant network facilities in Europe, including metropolitan area networks in London, Paris, Frankfurt, Stockholm, Amsterdam and Brussels, as well as switching facilities in various other European cities. MCI terminates a significant amount of its international traffic in Europe. At present, virtually all of that traffic is terminated at above-cost settlement rates pursuant to traditional correspondent arrangements. As MCI begins to terminate its European traffic via WorldCom's facilities, its termination costs will decrease significantly.

Similarly, WorldCom plans to realize significant savings by terminating its traffic over the facilities of MCI's affiliates in Mexico and New Zealand, as regulatory conditions permit. At present, WorldCom sends almost twice as much traffic to Mexico as to any other foreign country. The quality of service and cost savings benefits of providing service on an end-to-end basis will also be important in Asia, as WorldCom constructs facilities there, and in Latin America, as MCI's partners build facilities there.

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<sup>65</sup> International Settlement Rates, IB Docket No. 96-261, *Report and Order*, FCC 97-280, ¶. 172 (rel. Aug. 18, 1997).



The savings to be generated and efficiencies to be gained by directly terminating traffic overseas on the merged carrier's (as opposed to the incumbent carrier's) facilities are similar to the savings and efficiencies to be gained domestically by terminating traffic on the merged carrier's (as opposed to the incumbent local exchange carrier's) facilities. By avoiding settlement costs for overseas termination and access charges for domestic termination, the merged carrier will be able to reduce its costs and lower its rates for international traffic. As a result, the merged carrier will be a more effective competitor.<sup>66</sup>

**B. Relevant Product and Geographic Markets**

**1. The Relevant Product Market is U.S. International Services.**

In the Joint Reply, the Applicants demonstrated that, for purposes of analyzing this merger, International Message Telephone Service (IMTS) and non-IMTS (primarily international private line services) should not be considered separate end user product markets. GTE is simply wrong in arguing that this approach is inconsistent with Commission precedent. MCI and WorldCom are merely recommending that the Commission define the product market as it did last year in *BT/MCI*: U.S. outbound international services.<sup>67</sup> MCI and WorldCom submit that the Commission's 13- year-old *International Competitive Carrier* decision,<sup>68</sup> finding IMTS and non-IMTS services to constitute separate products, has been superseded by technological, marketplace, and regulatory developments

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<sup>66</sup> See Hall Decl. ¶ 97; *see also* discussion of public interest benefits, Section VII, *infra*.

<sup>67</sup> *BT/MCI* at ¶. 54-55.

<sup>68</sup> See *International Competitive Carriers Policies, Report and Order*, 102 F.C.C.2d 812, 821-24 (1985), *recon. denied*, 60 Rad. Reg. (P&F 2d) 1435 (1986), *modified* 7 FCC Rcd 577 (1992).

that largely blur the functionality of switched voice and private line offerings.

GTE's contentions that IMTS and private line services "are not substitutable, have distinct characteristics, and are designed to meet different customer needs" are simply no longer valid. *GTE Comments* at 46. As the Applicants previously noted and the Commission is well aware, private lines routinely are used to provide switched voice (and fax) services by means of international simple resale ("ISR"), "switched hubbing," and "leaky PBXs." Moreover, large customers routinely use international virtual private networks, by which traffic is routed via the public switched network, in place of international private lines.

In the next six to twelve months, this convergence will accelerate as the Commission approves the provision of ISR to many new, high volume destinations. Further, GTE is not correct that the convergence of IMTS and international private lines is only relevant as a product input, but not as an end user output. Although the ultimate end user may seek IMTS services, if the underlying or resale carrier is providing switched voice service via private lines, the end user is, in fact, purchasing (perhaps unknowingly) a fully substitutable international private line service. The same is true when a customer connects a private line through a PBX to the public switched network (*i.e.*, a "leaky PBX"). Moreover, with the advent of "switched hubbing," an international private line circuit between the United States and a foreign country has the capability of providing the same "any-to-any" service to third countries that GTE mistakenly attributes exclusively to traditional IMTS services.

Even if IMTS and international private line service offerings to end users were to be considered separate markets, the Applicants have previously demonstrated, and demonstrate here again, that the merger would not create market power or present any anticompetitive concerns with

respect to the provision of either service offering.<sup>69</sup> Based on 1996 data, the merged entity would have a 27 percent share of IMTS revenue, a 44 percent share of international private line revenue, and a 28 percent share of combined IMTS and international private line revenue.<sup>70</sup> These market shares are far less than the market shares AT&T possessed when the Commission declared it nondominant for the provision of IMTS.<sup>71</sup>

**2. There is No Reason to Analyze Each Country Route Separately In This Proceeding.**

In its comments, GTE objects to the Applicants' assertion that the Commission should analyze the competitive effects of the merger on a world-wide, rather than route-by-route, basis. Contrary to GTE's protestations, this approach is fully consistent with Commission precedent and

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<sup>69</sup> GTE attempts to make an issue of the fact that, for nine routes, MCI and WorldCom would have 100 percent of the international private line revenues. GTE fails to mention, however, that it is not unusual for all of the international private line revenues on low traffic routes to go to a single carrier. Currently, on at least 38 such routes, a single carrier receives 100 percent of the private line revenue. *See* Federal Communications Commission, 1996 Section 43.61 *International Telecommunications Data Report* at Table F (Feb. 1998).

The combined international private line service revenues on the routes GTE cites represent a tiny fraction -- 0.40 percent (\$2.7 million) -- of the total U.S. international private line revenues for 1996 (\$660.7 million). *See id.* at Tables B21 & B36. The average number of 64 kbps circuits provided on each of these low volume, low revenue routes is less than seven. Clearly, these routes are *de minimis*. Further, in no case would the merged carrier be the only carrier serving the route or the only choice for potential customers. On the nine routes where MCI and WorldCom had 100 percent of the 1996 international private line revenues, such revenue was less than three percent of the IMTS revenue on such routes. *See id.* at Tables A1, B21 & B36.

<sup>70</sup> *Id.* As a total percentage of all international revenues, private line services account for only 4.4 percent. *See id.* at Figure 7.

<sup>71</sup> *See* In the Matter of Motion of AT&T Corp. to be Declared Non-Dominant for International Service, *Order*, 11 FCC Rcd 17963, 17975, at ¶ 33 (rel. May 14, 1996) ("*AT&T International Non-Dominance Order*").

makes sense in this case.

In the *AT&T International Non-Dominance Order*, the Commission took a similar approach. In that proceeding, the Commission found that, with the exception of routes where AT&T was the sole facilities-based provider, AT&T's market position did not vary substantially from one geographic market to the next. Thus, in examining whether AT&T was dominant in the U.S. international services market, the Commission used AT&T's market position on a worldwide basis as a surrogate for a route-by route analysis of AT&T's market position for each of more than two hundred international locations.<sup>72</sup>

In the *BA/NYNEX Order*, the Commission stated that it would treat as a single relevant geographic market, "an area in which all customers in that area will likely face the same competitive alternatives for a [relevant] product."<sup>73</sup> Although the Commission generally has considered each international route between the United States and a foreign country to be a separate geographic market, for purposes of this merger, which involves two U.S. international carriers, *all* U.S. international routes are relevant. The merged carrier's competitive position will not vary substantially by geographic market. As MCI/WorldCom noted in its initial Joint Reply, the merged carrier will not have corporation affiliation with or ownership of any dominant foreign carrier,<sup>74</sup> nor will it be the exclusive U.S. facilities-based provider on any international route. Moreover,

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<sup>72</sup> See *AT&T International Nondominance Order*, 11 FCC Rcd at 17976 (¶ 35).

<sup>73</sup> Memorandum Opinion and Order, FCC 97-286, 9 Comm. Reg. (P&F) 187, at ¶ 54 (rel. Aug. 14, 1997) ("*Bell Atlantic/NYNEX Order*").

<sup>74</sup> WorldCom and MCI, however, have recently announced a multi-faceted joint venture with Telefonica de Espana. See "Telefonica Partners with WorldCom and MCI," PR Newswire, Mar. 9, 1998.

international telecommunication customers increasingly enjoy similar competitive choices on different routes. Thus, it is unnecessary for the Commission to examine separately each of several hundred geographic markets.

In addition, a route-by-route analysis is wholly inconsistent with the rapid changes in traffic routing which have occurred in the past few years, and which will accelerate substantially in the next few years as a result of marketplace, regulatory, and technological changes. Many carriers now route substantial amounts of international traffic via one or more intermediary countries. Such third-country routing makes route-by-route market shares far less meaningful. The reality is that the geographic market for the provision of international telecommunications service is global and, furthermore, that such services originate outside the United States, typically by incumbent national carriers, as well as inside the United States. U.S. carriers compete with each other and with foreign carriers for all such traffic.

### **C. Actual, Potential, and Precluded Competitors**

GTE claims that MCI/WorldCom have overstated the list of most significant competitors in the U.S. international market. GTE's concerns are groundless. MCI/WorldCom's statements are fully supported by the Commission's findings in *BT/MCI* and by recent regulatory and market developments.

In *BT/MCI*, the Commission identified actual and precluded competitors in each relevant international end user and input market.<sup>75</sup> The Commission's findings should be similar, if not the same, in this proceeding. In addition, in recent months, a number of foreign carriers with significant

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<sup>75</sup> See *BT/MCI* at 65.

capabilities and incentives have become actual competitors in the U.S. international market and more are expected.

In examining the market for mass market customers making U.S.-U.K. outbound international calls, the Commission in *BT/MCI* found that AT&T, MCI, Sprint, and GTE are actual competitors and among the most significant market participants.<sup>76</sup> The BOCs were found to be precluded competitors, but potentially among the most significant market participants for in-region international services.<sup>77</sup> These findings were based on these carriers' extensive facilities, operational infrastructure, brand name recognition and reputation, and existing customer base. These findings apply equally in the broader worldwide U.S. international service market at issue in this proceeding.

With respect to the provision of U.S.-U.K. outbound international calls to large- and medium-sized businesses, the Commission found that AT&T, MCI, Sprint, and GTE (among actual competitors), and the BOCs (among precluded competitors) are the most significant participants.<sup>78</sup> The Commission found that BT, WorldCom, Cable & Wireless (C&W), ACC, Frontier, Esprit, other interexchange carriers and various CAPs are among a large number of competitors that have, or potentially have, significant capabilities and incentives.<sup>79</sup> As the Commission recognized in the case of BT on the U.S.-U.K. route, the full-fledged entry of foreign carriers, made possible by the

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<sup>76</sup> See *BT/MCI* at ¶¶ 69-78.

<sup>77</sup> See *id.* at ¶¶ 76-77.

<sup>78</sup> See *id.* at ¶¶ 69-78.

<sup>79</sup> See *id.* at ¶¶ 69-79.

Commission's rules implementing the WTO Agreement,<sup>80</sup> will make this market segment even more competitive. These foreign carriers already own the requisite international facilities, and have substantial expertise and financial resources.<sup>81</sup> At least two of these foreign carriers, Teleglobe and C&W, had already developed substantial customer bases prior to receiving authorization to provide U.S. international facilities-based services to their affiliated markets. In addition, Qwest/LCI are developing the networks and customer bases to become significant participants.<sup>82</sup>

With respect to the international transport market, AT&T, MCI, Sprint, WorldCom, BT, C&W, Teleglobe, KPN (PTT Telecom Netherlands), Swisscom, KDD, and Telstra are among the large number of actual competitors. All of these carriers are not just authorized as international carriers, but are actually competing in the market. Other foreign carriers, including Deutsche Telekom ("DT") and France Telecom ("FT"), are likely to seek to enter the U.S. market themselves or through Global One, their joint venture with Sprint. Each of these actual and potential competitors owns at least one whole STM-1 of trans-oceanic capacity. Pursuant to the Commission's new foreign carrier participation rules, other foreign carriers not already authorized to provide

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<sup>80</sup> See generally Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, *Report and Order on Reconsideration*, IB Docket No. 97-142, FCC 97-398 (rel. Nov. 26, 1997) ("*Foreign Carrier Participation Order*").

<sup>81</sup> See *BT/MCI Order* at ¶. 73 ("BT has developed relevant network operating capabilities as a consequence of providing service on the U.K.-U.S. outbound route. With respect to the large international business market, BT also has some brand name recognition and reputation, as well as a small number of existing customer relationships, in the United States.").

<sup>82</sup> Qwest Communications International, Inc. and LCI International Inc. have agreed to a merger that will create the fourth largest long distance carrier and a formidable competitor in the U.S. international services market. Stephanie Mehta, "Qwest is Acquiring LCI for \$4.43 Billion, Creating No. 4 Long-Distance Provider," *Wall Street Journal*, March 13, 1998.

international facilities-based services to all points, including their affiliated markets, likely will soon be so authorized. In addition, with the availability of new high capacity submarine cable systems, other new carriers are likely to become actual participants.

**D. There are Low Barriers, If Any, to Entry and Expansion in the Relevant Markets.**

As MCI/WorldCom indicated in its initial Joint Reply, there are no material barriers to entering and competing in the international services market. Not surprisingly, GTE does not even attempt to refute MCI/WorldCom's showing about the ease of entry. There are hundreds of competitors, including GTE and many foreign carriers, in the market. New entrants need not incur significant sunk-cost investments, and regulatory barriers to entry by foreign-affiliated carriers have largely been eliminated. The Commission's new rules on foreign carrier participation now make it much easier for foreign carriers from WTO member countries to enter the U.S. market.<sup>83</sup>

Likewise, barriers to owning international transport facilities between the United States and foreign markets have all but disappeared. Regulatory and commercial barriers to obtaining capacity on an ownership basis in existing submarine cables, or to constructing and operating new cables, are low.<sup>84</sup> In most of Europe, as well as in Japan, Australia, and New Zealand, submarine cable systems

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<sup>83</sup> See generally, *Foreign Carrier Participation Order*.

<sup>84</sup> In addition, carriers can engage in commercial deals to gain capacity. For example, Teleglobe recently agreed to swap some of its transatlantic capacity with Qwest for capacity on Qwest's U.S. domestic network. See News Release, "Qwest Extends Network To The United Kingdom -- Exchange of Bandwidth Assets Allows Delivery of Data and Voice Communications Services in Europe," January 12, 1998 (available at < <http://www.qwest.com/press/11298.html>>).



may be 100 percent foreign-owned.<sup>85</sup> Moreover, the unit cost of new construction has decreased dramatically. As the Commission recognized in *BT/MCI*, "the recent reduction in regulatory barriers to entry, combined with a decrease in the cost of constructing new transoceanic cables, should lead to more rapid construction of cable capacity. . . ."<sup>86</sup>

**E. The merger will not have anticompetitive effects in any of the relevant markets.**

As demonstrated in the Applicants' Joint Reply, the merger will not have anticompetitive effects in any of the relevant markets. As an initial matter, MCI/WorldCom do not believe the markets need to be analyzed in terms of different customer groups because there is no credible evidence that there is or could be a lack of competitive performance with respect to any particular group of customers.<sup>87</sup>

Even if the merger is analyzed in terms of different customer groups, it is clear that the merger will not adversely affect any group of customers. GTE makes the unsubstantiated claim that the proposed merger will "affect small businesses and residential customers by diminishing competition in the provision of IMTS services, which could lead to higher prices."<sup>88</sup> Contrary to GTE's claim, the elimination of WorldCom as a separate competitor in the provision of U.S. international services to mass market (*i.e.*, residential and small business) customers will not have any adverse effects on competition. WorldCom lacks the brand name recognition and customer base that

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<sup>85</sup> Most other WTO member countries have made commitments to allow partial or full foreign ownership of cable systems.

<sup>86</sup> *BT/MCI*, at ¶ 140.

<sup>87</sup> *LEC In-region Interexchange Order*, at ¶ 40.

<sup>88</sup> GTE Comments at 50.

the most significant actual and precluded participants, including AT&T, MCI, Sprint, GTE, and the BOCs, possess. Thus, WorldCom's merger with MCI will have little competitive impact in the provision of international services to mass market customers.

Nor will WorldCom's withdrawal as a separate competitor in the provision of U.S. international services to large- and medium-sized business customers have any adverse effects on competition. As MCI/WorldCom explained above, there are a number of other carriers, including actual competitors AT&T, MCI, Sprint, and GTE, and precluded competitors such as the BOCs, that are at least as significant participants as WorldCom is in this market segment. These carriers all have extensive facilities, brand name recognition and reputation, and established customer bases. In addition, carriers such as Qwest/LCI, Teleglobe, C&W, and BT also have the capabilities and incentives -- including expanding facilities and growing customer bases -- to be significant participants. Likewise, previously precluded foreign carriers also have the capabilities and incentives to become significant competitors, particularly in serving their affiliated markets.

GTE also has claimed, but offered no credible evidence, that the proposed merger will have adverse effects on large businesses and resellers through increased concentration in the provision of private line services. MCI/WorldCom have already demonstrated that the private line services shall not be considered separately from IMTS services, but that, in any cases, the merger will not have an adverse effect on the provision of international private lines.<sup>89</sup> Moreover, large businesses and resellers are highly sophisticated buyers that will seek the best deal from alternative providers. In addition, since the terms of each deal are private, there is no opportunity for "price signalling"

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<sup>89</sup> See pp. 51-53, *supra*.

among carriers.<sup>90</sup>

Finally, the elimination of WorldCom as a separate competitor in the market for U.S. international transport will not have any adverse effects on competition. AT&T, MCI, BT, Sprint, C&W, and Teleglobe are at least as significant participants as WorldCom is in this market. In addition, GTE and Qwest/LCI also have the capabilities and incentives to be significant participants. Likewise, previously precluded foreign carriers such as DT, FT, and KDD own whole circuit facilities that would enable them to become significant competitors in this market segment. Moreover, given the ease of entry, new carriers and non-carriers can construct and operate cable systems.

GTE is flatly wrong in arguing that new undersea cables planned in the near future will be owned substantially by existing carriers, which might discriminate against new carriers that would use the capacity to compete with them. GTE fails to recognize the growing diversity of international transport ownership. MCI/WorldCom already addressed this issue extensively in their initial Joint Reply. In the transatlantic region, MCI/WorldCom would own only 16.6 percent of the total cable capacity, and only 22.6 percent of the "western end" of transatlantic capacity. In addition, the Atlantic Crossing cable system ("AC-1") is expected to begin service in May 1998. This system, which will add 128 STM-1s of capacity, will more than double the transatlantic capacity available at the end of 1997.<sup>91</sup>

In addition, GTE completely misrepresents MCI/WorldCom's questioning of the use of TAT-

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<sup>90</sup> *Bell Atlantic/NYNEX*, at ¶ 53.

<sup>91</sup> Each STM-1 equals 63 E-1s.

12/13 as a proxy for all transatlantic cable capacity. MCI/WorldCom objected to GTE's use of TAT-12/13 as a proxy for *all* transatlantic capacity in this proceeding because TAT-12/13 is no longer representative of transatlantic capacity. It was appropriate for the Commission to use TAT-12/13 as a proxy for all existing transatlantic capacity at the time of *BT/MCI* decision in September 1997.<sup>92</sup> However, the Commission acknowledged in that decision that new capacity would be available in the future. Indeed, conditions have changed over the last six months; new cable facilities are now a reality. Gemini is now operational, and AC-1 is expected to be operational by May 1998. These systems increase by many times the available capacity to all carriers, including new or emerging carriers. GTE would have the Commission ignore these important new developments.

Moreover, even if ownership in TAT-12/13 is examined alone, there is no reason to believe that MCI/WorldCom's ownership of 27.9 percent of U.S.-end capacity would create or facilitate the exercise of market power.<sup>93</sup> Fully 72.1 percent of the U.S.-end of TAT-12/13 is owned by other carriers. These include AT&T, Sprint, BT, C&W, DT, KDD, KPN, Tele2, and Telia, each of which owns at least one whole STM-1. All of these carriers are authorized to provide facilities-based U.S. international services.

In the Pacific region, TPC-5 is the most recently deployed common carrier cable. The merged entity would own approximately 14 percent of the capacity on this system. A number of other U.S. and foreign carriers, including AT&T, Sprint, and KDD, own significant capacity in this

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<sup>92</sup> *BT/MCI*, at ¶97.

<sup>93</sup> AT&T owned 43.2 percent of the U.S. end of total international submarine capacity when it was declared nondominant for the provision of IMTS. See *AT&T International Non-Dominance Order*, 11 FCC Rcd at 17982 (¶ 53 n.98).

cable. In addition, a number of new cable systems are planned. For example, fourteen U.S. and foreign carriers have applied to the Commission for a cable landing license for a high-capacity cable system linking the United States, Japan, China, and Taiwan. NTT and several other carriers also are planning a cable system that will link the United States and Japan. WorldCom recently received a cable landing license for the Southern Cross cable system, which will link the United States, Australia, and New Zealand. Each of these facilities is planned to be operational within the next two years.

#### **F. Conclusion**

In summary, MCI and WorldCom have clearly demonstrated in this proceeding that the proposed merger will have significant procompetitive benefits and will not reduce competition in any relevant international product market. GTE has not presented any credible evidence to undermine this showing.

**V. THE MERGER WILL NOT REDUCE COMPETITION IN THE PROVISION OF INTERNET SERVICES**

Out of more than four thousand domestic Internet service providers (“ISPs”), only three have opposed the merger. Two large backbone competitors of WorldCom and MCI, GTE and Sprint, and one smaller provider, Simply Internet, contend that the proposed merger would give MCI WorldCom the power to overcharge and otherwise mistreat ISPs seeking connectivity to ISP and non-ISP customers served by MCI WorldCom. Notably, none of the other potential victims of this alleged dominance apparently shares this concern. GTE and Sprint, of course, are major Internet providers with the least to fear from any hypothetical dominant firm, and GTE is also a disappointed bidder for MCI.<sup>94</sup> Two BOCs, Bell Atlantic and BellSouth, also recycled arguments made in previous rounds, primarily to advance their agenda under §§ 271 and 706. A straightforward application of the standards articulated by the Commission in the *Bell Atlantic-NYNEX Order* demonstrates that these competitors’ arguments are meritless.

The Internet is characterized by vigorous competition, easy entry, and open architecture -- all of which combine to produce dramatic growth. As a result, any attempt by any one ISP to try to raise prices to other ISPs or retail customers above the competitive level or to degrade the quality of service to any of them would only cause other participants in the Internet to avoid that ISP. Such an attempt would backfire, leaving the ISP with fewer customers and a significantly reduced market share. That explains why the head of GTE’s Internet group responded as follows when asked, after

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<sup>94</sup> According to GTE’s figures, a merger of GTE and MCI would have combined the largest and fifth largest ISPs (MCI and itself) to form an ISP more than 50 percent larger than the next largest ISP, and the merger would have produced an increase in the HHI of over 200 points, more than sufficient to raise an issue under the Merger Guidelines. *See Harris Internet Aff.* ¶¶ 52, 58. GTE nevertheless viewed that merger with considerable enthusiasm.

WorldCom announced its bid for MCI but before GTE made its bid, whether a WorldCom-MCI combination would put so much power in a single company that it could restrain competition:

I am not worried. There are still many other backbone providers and the combination of any two does not pose any real problem.<sup>95</sup>

Opponents of the merger generally claim to honor the express statutory policy “to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, *unfettered by Federal or State regulation.*” 47 U.S.C. § 230(b)(2) (emphasis added). *See, e.g.,* Sprint Comments at iii, 5. But restricting economic arrangements between MCI and WorldCom, including imposing Internet-related conditions on MCI WorldCom that do not apply to its competitors, would fetter unregulated market forces that have driven the Internet’s extraordinary growth. The statutory policy expressed in § 230(b)(2) does not permit any presumption against mergers of Internet providers. Under the *Bell Atlantic-NYNEX* standard, carriers that provide regulated telecommunications services may not merge unless they show that the merger would promote the public interest. But for the Internet, the presumption should be that the government should not block or condition a merger unless the record supports a finding that the merger harms the public interest. The burden should be on opponents of the merger to show affirmatively that it would harm competition. Indeed, the Commission should not intervene without compelling evidence of imminent failure in the market that includes Internet service, and the record could not conceivably support such a finding. *See* Joint Reply at 68.

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<sup>95</sup> Interview of John Curran, Chief Technical Officer of GTE Internetworking, on Oct. 6, 1997 (available at < <http://www.essential.org/listproc> >).

## **A. The relevant product and geographic markets**

As explained in the preceding sections, the first step in the competitive analysis is to determine the relevant product and geographic markets.

### **1. Product markets**

The Commission has not defined relevant product markets for Internet services in any prior proceeding. A wide variety of services are offered over the Internet. From the demand-side perspective, many capabilities provided by the Internet are provided by other services as well. Some services that can be provided over the Internet, such as intranets, electronic mail and Internet telephony,<sup>96</sup> fall into familiar categories with obvious non-Internet-based substitutes. Any attempt by a hypothetical monopolist to raise the price of these services would only cause potential customers to purchase substitutable services. Other services, such as Internet “chat rooms,” Website visitation, and Internet video and radio, face competition from non-Internet alternatives that may not be as close substitutes.<sup>97</sup> Such services may provide some of the capabilities that these Internet services offer, but not the global reach on a scale offered by the Internet.

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<sup>96</sup> Internet telephony services permit real-time voice conversations over the Internet. These services convert voice into data packets, which are then sent over the Internet, and converted back into voice at the receiving end.

<sup>97</sup> Internet “chat room” service allows multiple Internet users to engage in a real-time “conversation” by sending and receiving typed messages as they are typed at a computer. Internet video and radio may blur the distinction between telecommunications and broadcast. A continuous, live, generally available music broadcast over the Internet may become indistinguishable from a traditional radio broadcast. Current technological limitations means that continuous video streams over the Internet are relatively low quality, and easily distinguishable from traditional radio and television images. However, “[a]s compressing technology develops and end-user access speeds increase, Internet video applications will provide service that increasingly resembles the quality of television broadcast stations.” Kevin Werbach, “Digital Tornado: The Internet and Telecommunications Policy,” OPP Working Paper 29, March 1997, at 42 (“*Digital Tornado*”).



The Commission has defined a relevant product market to encompass a group of similar services where each service is a good substitute for another, but where, for the group as a whole, there are no other close substitutes in demand.<sup>98</sup> Purchasers of Internet access generally obtain access to all services provided over the Internet for a flat monthly cost (whether for dial-up or dedicated service). As a result, an ISP generally cannot raise the price of access to Internet services for which less close substitutes exist without simultaneously raising the price of access to Internet services for which close substitutes do exist. The parties are not aware of any empirical analysis that determines whether any Internet services, individually or collectively, are sufficiently different from non-Internet services that the latter do not effectively constrain the pricing of the former.

Some opponents of the merger argue that the relevant market consists of Internet backbone services. *E.g.*, Sprint Comments, at 8. However, as WorldCom and MCI previously demonstrated, there is no generally accepted definition of “Internet backbone,” and the difference between an ISP “backbone” provider and other ISPs is at best one of degree. Joint Reply at 69 and n.111. Sprint unintentionally confirms this point when it tries to draw a distinction between two tiers of Internet backbone providers without explaining where the line is drawn, for example, in terms of the extent to which the “core” backbone provider owns or leases transmission capacity or the number of NAPs to which a “core” backbone provider must interconnect. *Id.*, at 7-8. Sprint acknowledges that ISPs vary widely in “size, scope, customer base, web sites, connected [to] their networks, [and] the services they can offer other ISPs.” *Id.* at 7.

Internet access services sold to ISPs are no different from Internet access services sold to

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<sup>98</sup> *LEC In-Region Interexchange Order*, 12 FCC Rcd. at 16751, 15777, 15782, ¶¶ 5, 31, and 40.